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Macroeconomic and Monetary Developments First Quarter Review 2006-07

The Reserve Bank of India today released the document “Macroeconomic and Monetary Developments: First Quarter Review 2006-07” to serve as a backdrop to the First Quarter Review of the Annual Statement on Monetary Policy for 2006-07.

The highlights of macroeconomic and monetary developments during 2006-07 so far are:

The Real Economy

- The cumulative rainfall recorded during June 1 to July 12, 2006 was 10 percent below normal as compared with one per cent above normal a year ago.
- Industrial production continued with its momentum during April-May 2006 registering growth of 9.8 per cent. The manufacturing sector with double digit growth (10.9 per cent) continued to be the key driver of industrial activity, contributing almost 92.5 per cent of the growth in industry.
- The infrastructure sector recorded growth of 5.9 per cent during April-May 2006 as compared with 7.1 per cent during April-May 2005.
- The buoyancy in manufacturing and services sector activities and the positive business confidence and expectations suggest that the recent growth momentum in the Indian economy is likely to be maintained in 2006-07, as has also been projected by different agencies.

Fiscal Situation

- All the key deficit indicators of the Central Government during April-May 2006, as proportion to budget estimates, were placed higher than their levels a year ago. Revenue receipts during April-May 2006, as proportion to budget estimates, were higher than in the corresponding period of 2005. Aggregate expenditure was, however, even higher during April-May 2006 on account of increase in interest payments, subsidies, grants to States, and also front loading of transfers to the Public Account of funds for

the Central Road Fund and National Rural Employment Guarantee Fund.

- During 2006-07 (up to July 18, 2006), gross and net market borrowings (including dated securities and 364-day Treasury Bills) raised by the Centre amounted to 38.2 per cent and 30.4 per cent of the budget estimates as compared with 37.2 per cent and 39.1 per cent, respectively, a year ago.
- During 2006-07 so far (up to July 18, 2006), the States have raised market loans amounting to Rs. 7,343 crore (30.1 per cent of gross allocation for the year).
- The weekly average utilisation of WMA and overdraft by the States during April-June 2006 (Rs.316 crore) was substantially lower than during the corresponding period of the previous year (Rs.1,449 crore). The weekly average investment by the States in the 14-day Treasury Bills during April-June 2006 amounted to Rs.35,859 crore, considerably higher than that of Rs.21,847 crore during the corresponding period of the previous year.

Monetary and Liquidity Conditions

- Monetary and liquidity conditions, after some tightening during the last four months of 2005-06, remained comfortable during the first quarter of 2006-07 despite sustained growth of bank credit.
- Bank deposits and credit recorded strong growth during the first quarter of 2006-07. Bank deposits and credit have increased by Rs. 66,268 crore and Rs. 40,789 crore, respectively, during the fiscal year 2006-07 so far (between March 31, 2006 and July 7, 2006) as compared with Rs. 20,386 crore and Rs. 26,053 crore, respectively, during the corresponding period of 2005-06 (between April 1, 2005 and July 8, 2005). Scheduled commercial banks' non-food credit, on a year-on-year basis, registered a growth of 32.9 per cent as on July 7, 2006 on top of a high base of 31.0 per cent a year ago.
- Money supply (M3) expanded by 18.8 per cent on a year-on-year basis as on July 7, 2006 as compared with 13.8 per cent a year ago.
- Reserve money expanded by 16.0 per cent on a year-on-year basis as on July 14, 2006 as compared with 18.0 per cent a year ago.

Price Situation

- Headline inflation firmed up further in several countries during the first quarter of 2006-07 in response to sustained pressures from record high international crude oil prices. Core inflation and inflation expectations which had so far remained relatively benign have also edged higher in recent months. With a significant part of the increase in international crude oil prices being considered

as permanent, many central banks tightened monetary policies further to contain inflation and inflationary expectations.

- In India, supply-side factors continued to be the major factors driving inflation during the first quarter of 2006-07. Apart from higher oil prices, primary food articles prices also posed upward pressure on inflation in the first quarter. Nonetheless, headline inflation remained within the indicative trajectory during the first quarter of 2006-07.
- In India, year-on-year wholesale price inflation was 4.7 per cent on July 8, 2006 as compared with 4.5 per cent a year ago.

Financial Markets

- Call money rates eased during the quarter and remained generally close to the reverse repo rate. Interest rates in the collateralised segment of the overnight money market remained below the reverse repo rate and the call rate during the quarter.
- The foreign exchange market remained orderly even as the Indian rupee depreciated during May-June 2006.
- Yields in the Government securities market hardened during the quarter. The yield curve steepened as the increase at the longer end was higher than at the short-end.
- Deposit and lending rates edged up during the quarter as credit demand remained strong.

The External Economy

- India's balance of payments position remained comfortable during 2005-06, despite pressures from record high international crude oil prices. The current account deficit remained modest at 1.3 per cent of GDP. Net inflows under major components of capital flows were higher than a year ago and the overall balance of payments (BoP) recorded surplus during 2005-06.
- Developments during April-June 2006 indicate continued robust growth of merchandise exports and non-oil imports, despite some deceleration. Oil imports remained large in view of further hardening of international crude oil prices. The trade deficit expanded from US \$ 10.5 billion during April-June 2005 to US \$ 12.6 billion during April-June 2006.
- Capital flows, except FII flows, have remained buoyant during 2006-07 so far.
- India's foreign exchange reserves at US \$ 162.7 billion on July 14, 2006 were US \$ 11.0 billion higher over end-March 2006.

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